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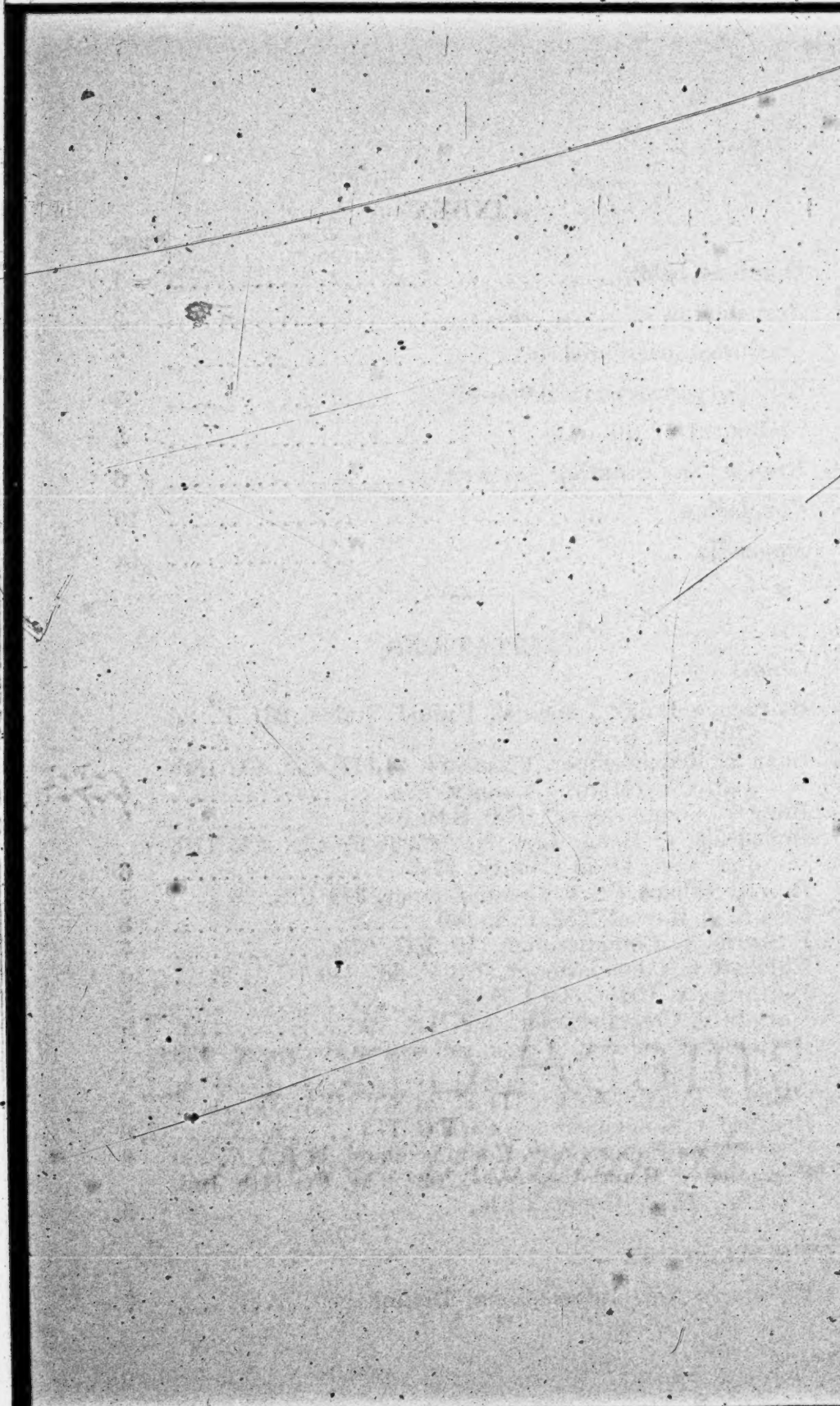
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

No.

JAMES T. BENN, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The petitioner, James T. Benn, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in the above-entitled proceeding on October 6, 1966, as amended and reaffirmed on November 15, 1966.

OPINIONS BELOW

The memorandum opinion of the Tax Court is reported at 22 TCM 707 and is reproduced in the Appendix hereto, p. 2a, *infra.*

The per curiam order of the Court of Appeals of October 6, 1966, affirming the judgment of the Tax

Court, is reported at 366 F. 2d 778 and appears in the Appendix hereto, p. 1a, *infra*. The per curiam order of the Court of Appeals of November 15, 1966, denying the petition for rehearing and reaffirming the judgment of the Tax Court, is not yet officially reported; it appears in the Appendix hereto, pp. 1a-2a, *infra*.

JURISDICTION

After a trial ending three years previously, the opinion of the Tax Court was entered on May 31, 1963, and its decision was entered on April 3, 1964. Upon a timely filed petition for review, the Court of Appeals affirmed the Tax Court's judgment on October 6, 1966. Thereafter, on November 15, 1966, the Court of Appeals denied a timely petition for rehearing and reaffirmed the Tax Court's judgment, adding certain comments in so doing. On February 10, 1967, Mr. Justice Black signed an order extending the time for filing this petition for writ of certiorari to and including March 31, 1967. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (1).

QUESTIONS PRESENTED

1. Whether, for federal income tax purposes, the delivery of a valid and binding promissory note, one that is both negotiable and interest-bearing, must be considered as part of the cost of acquiring real property, especially where such note is eventually paid.

2. Whether the Tax Court is bound by the decisions of state courts of competent jurisdiction, resolving matters of property rights and interests, in determining issues of fraud and cost of acquired property.

STATUTORY PROVISION INVOLVED

Section 113 (a) of 1939 Internal Revenue Code; Section 1012 of 1954 Internal Revenue Code:

> "The basis of property shall be the cost of such property . . ."

STATEMENT OF THE CASE

After first declaring that the issues in this case "are purely issues of fact" as to which the Tax Court's resolution was proper, the Court of Appeals on rehearing was forced to amend its opinion to read (see Appendix hereto, p. 2a, *infra*):

> "The Tax Court correctly dealt with the legal questions and the mixed questions of law and fact. None of these is of sufficient significance to require an opinion by this Court. All of the remaining issues were purely questions of fact. They were decided by the Tax Court upon evidence which it was entitled to credit. The decision by the Tax Court on these issues is not clearly erroneous, and it is therefore affirmed."

Disregarding the voluminous facts underlying the purely factual issues, this petition presents only those facts relevant to the legal issues here at stake. It is enough to note, by way of background, that the proceedings before the Tax Court involved alleged deficiencies and additions to tax in petitioner's federal income taxes for the years 1951 to 1955, inclusive. Petitioner, a general building contractor, had engaged in the acquisition, holding for investment, and sale of numerous pieces of real estate during those years, out of which developed the various tax issues.

A. The Promissory Notes

In computing petitioner's costs and expenses with regard to most of the properties sold by petitioner during the years in question, the Tax Court included promissory notes given by petitioner in acquisition of the properties only to the extent of their fair market value—which the Tax Court found to be zero. The Tax Court stated that while petitioner in legal theory might be legally liable on these notes, "there appeared to be little likelihood that he would ever pay or could be required to pay them." Appendix, p. 4a, *infra*. In giving these notes to the sellers of those properties, said the Court, petitioner had given "nothing substantially equivalent to cash, and he is not, as a cash-basis taxpayer, to be permitted to deduct as costs or include in his basis any amount for these notes until such time as they are actually paid." Appendix, p. 4a, *infra*.

As indicated by the Tax Court, however, petitioner was legally obligated to pay all these promissory notes. The notes were valid, negotiable and interest-bearing. And, in point of fact, petitioner did eventually pay, prior to the Tax Court trial, all the notes in connection with the transactions challenged by the Court. A determination of the actual cost to petitioner was thus possible in the light of all the relevant facts.

B. The State Court Decisions

In connection with its various findings as to petitioner's tax bases and alleged fraud on his part, the Tax Court made the following determinations:

(1) The Tax Court treated petitioner's cost of acquiring the Stonesthrow Apartments as zero. That property had been exchanged between petitioner and

his ex-wife, Florence M. Redelsheimer, in an attempt to settle their affairs and return themselves to status quo ante, following an annulment of the marriage. As part of that arrangement, petitioner gave his ex-wife a promissory note for $37,500; clearly marked on the reverse side was a notation that petitioner's liability on the note was subject to offsets and liabilities in favor of petitioner against his ex-wife, a condition acknowledged by the ex-wife. These offsets and credits represented money and other property of value given by petitioner to his ex-wife during his marriage and which, as a result of the annulment, petitioner was legally entitled to recover. See Tr. 2127, 2145, 2148.

In disregarding petitioner's offsets, claims and credits against his ex-wife in connection with this note, the Tax Court ignored the Florida state court decree which annulled the marriage. See *Benn* v. *Redelsheimer,* Chancery 13-117, Circuit Court of the Sixteenth Judicial Circuit of the State of Florida in and for Monroe County, dated May 28, 1952. Instead, the court treated the parties as having been divorced and labeled their relationship as bigamous. But had the Tax Court given heed to the annulment decree, wherein the offsets, claims and credits reflected on the back of the Stonesthrow note were recognized as property rights of the petitioner, the cost of acquiring the apartments would have been considered as far in excess of zero.

(2) The Tax Court, sharply critical of petitioner's business practices, labeled as fraudulent a transaction involving a $13,600 note made by one Andy Viglianco —which petitioner allegedly raised in amount from $30.00. In making this finding of forgery, the Tax Court ignored a decision of the Circuit Court of Dade

County, Florida, which accepted the verdict of a jury that such a forgery never occurred. See *Viglianco* v. *Benn, et al.*, Law No. 27028, in the Circuit Court of the Eleventh Judicial Circuit of the State of Florida in and for Dade County. These Florida determinations resulted in a judgment against Viglianco for $13,600, plus costs and interest—totalling $16,930. See Tr. 1737; Exs. 7-G, 35, 36.

(3) The Tax Court further found that petitioner had suffered no loss as a result of a business failure in which petitioner had advanced certain monies, $8000 of which had in turn been advanced by one Dominick Dellaquila. Dellaquila demanded the return of his money from petitioner, who agreed to take over Dellaquila's interest and to give him an $8000 note. Dellaquila sued petitioner on this note and in 1952 obtained a judgment against petitioner in the amount of $8,639.98. See *Dellaquila* v. *Benn,* Law No. 25996-F, in the Circuit Court of the Eleventh Judicial Circuit of the State of Florida in and for Dade County. Petitioner paid this judgment debt in 1955 and reported the item as a bad debt loss for that year. The Tax Court disallowed the loss. See Tr. 1604, 1608, 1642-1651.

REASONS FOR GRANTING THE WRIT

1. An important question in the administration of the federal tax laws is raised concerning the use of legally binding promissory notes in computing the cost of property.

The Tax Court determination, affirmed by the Fifth Circuit, raises a significant problem in the administration of the federal income tax laws—whether and to what extent legally binding and negotiable promissory notes given to acquire property may be used in computing the cost of that property.

That problem finds no ready or definitive answer in the Internal Revenue Code or in the judicial deci-

sions thereunder. The pertinent Code provision (§ 113(a) of the 1939 Code and § 1012 of the 1954 Code) merely states that "The basis of property shall be the cost of such property." This Court has remarked that this language "normally means . . . cost to the taxpayer." *Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98, 102. But as the Tax Court has noted, neither the Code nor the regulations thereunder define the term "cost". *Edwards* v. *Commissioner*, 19 T.C. 275, 279. The Tax Court in that case accordingly adopted a definition of "cost" from Webster's New International Dictionary, defining that word to mean "the amount or equivalent paid, or given, or charged, or engaged to be paid or given for anything bought or taken in barter or for service rendered."

Such a definition is certainly broad enough to cover not only amounts of cash paid by the purchaser of property but also amounts "engaged to be paid" through the issuance of legally binding promissory notes—especially those that are negotiable, interest-bearing and are eventually paid. Such would indeed be the common-sense meaning of "cost" in terms of what the taxpayer actually pays for the properties. And in *Redford* v. *Commissioner*, 28 T.C. 773, the Tax Court followed this common-sense approach and held that a $61,000 promissory note, a note that was negotiable and secured by a first deed of trust, was includable in determining the cost of the property involved.[1]

But the Fifth Circuit's affirmance of the Tax Court action in this case has created further doubt and con-

[1] By a divided vote, however, the Tax Court in *Redford* excluded from the cost determination a second note for $25,000, which was non-interest bearing, non-negotiable and incorporated an agreement whereby the amount due might be less if certain conditions materialized.

fusion in the concept of "cost" by intermingling that concept with notions of allowability of deduction, particularly for bad debts. Citing such decisions as *Eckert* v. *Burnet,* 283 U.S. 140, *Helvering* v. *Price,* 309 U.S. 409, *Baltimore Dairy Lunch* v. *United States,* 231 F. 2d 870 (C.A. 8), and *Quinn* v. *Commissioner,* 111 F. 2d 372 (C.A. 5), the Tax Court here ruled that the promissory notes could not be included in the cost determination until actually paid, petitioner being a cash-basis taxpayer.

But all those cited decisions concerned the allowability of a deduction, especially a bad loss deduction, for payments made in the form of notes in a year prior to the maker being called upon to make good his note. In each case the deduction was disallowed on the tax theory that there is no doctrine of constructive payment equivalent to the doctrine of constructive receipt of income.[2] Obviously, a loss must be ascertainable in the year in which it is claimed as a deduction. But legal commitments in acquisition of property, for purposes of cost determination, involve more careful and sophisticated matters than merely determining how much cash is paid out in any given year. If cost, as this Court said in *Detroit Edison,* means "cost to the taxpayer," it would appear essential to determine the total cost to the taxpayer, including the amounts he is legally obligated to pay and does pay over a period of time by virtue of valid, binding and negotiable promissory notes.

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[2] The Tax Court also cited its prior decisions in *Skaneateles Paper Co.* v. *Commissioner,* 29 B.T.A. 150, and *Redford* v. *Commissioner,* 28 T.C. 773. The *Skaneateles* case involved deductions, not cost determination. The *Redford* case did involve cost determination and permitted a promissory note to be included in the determination; see discussion herein at footnote 1, *supra.*

This intensely practical and obviously recurring tax problem needs exploration by this Court, to the end that the existing confusion may be removed and certainty accorded the concept of cost determination in this context.

2. An important question is raised as to the duty of the Tax Court to recognize and apply state court determinations as to legal rights and interests.

The Tax Court, with the approval of the Fifth Circuit, has made various tax determinations without regard to certain judicial rulings of Florida trial courts of competent jurisdiction. Had those rulings been respected, the Tax Court would have had to revise its findings of fraud and revise its determination that petitioner suffered no loss in the Dellaquila matter. It would have had to recognize that petitioner, as the Florida jury had determined, committed no forgery in the Viglianco matter; it would have had to recognize that the *annulment* of petitioner's marriage involved a state court determination of petitioner's property rights and credits against his ex-wife, as reflected in the Stonesthrow promissory note; and the Tax Court would have had to recognize that the Dellaquila note did involve a bad debt loss.

This Court has already determined that state law "creates legal interests and rights" and that the federal revenue statutes merely "designate what interests or rights, so created, shall be taxed." *Morgan* v. *Commissioner*, 309 U.S. 70, 80. See also *Blair* v. *Commissioner*, 300 U.S. 5, 9-10. As a result, a matter of state law decided by a state tribunal of competent jurisdiction in an adversary proceeding determines the rights of the parties and to that extent is binding and conclusive with respect to the resulting federal tax liabil-

ity. In short, where there is no collusion, the state court litigation is determinative of the legal interests to which federal tax liability attaches. See *Flitcroft* v. *Commissioner*, 328 F. 2d 449 (C.A. 9); *Peyton's Estate* v. *Commissioner*, 323 F. 2d 438 (C.A. 8).

The failure of the Tax Court to respect the non-collusive, pertinent decisions of the Florida courts raises a question of significance in the administration of federal tax justice, a question deserving of consideration by this Court. That court needs to be reminded of its unswerving obligation to respect state court determinations of property rights as to which federal tax consequences ensue.

CONCLUSION

For these various reasons, this petition for writ of certiorari should be granted.

Respectfully submitted,

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March 31, 1967